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Via Overnight Mail

May 8, 2003

Thomas Dorman, Esq.
Executive Director
Kentucky Public Service Commission
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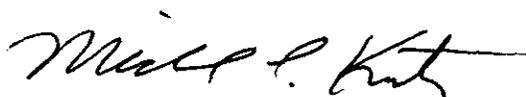
Re: Case No. 2002-00475

Dear Mr. Dorman:

Please find enclosed the original and twelve (12) copies of the Main Brief of Kentucky Industrial Utility Customers, Inc. in the above-referenced matter. By copy of this letter, all parties listed on the Certificate of Service have been served.

Please place this document of file.

Very Truly Yours,



Michael L. Kurtz, Esq.
BOEHM, KURTZ & LOWRY

MLK:kev
Attachment
cc: Certificate of Service

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by mailing a true and correct copy, by first-class postage prepaid mail, unless otherwise noted, to all parties on the 8th day of May, 2003.

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**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

IN THE MATTER OF:

APPLICATION OF KENTUCKY POWER)	
d/b/a AMERICAN ELECTRIC POWER, FOR)	
APPROVAL, TO THE EXTENT NECESSARY,)	CASE NO. 2002-00475
TO TRANSFER FUNCTIONAL CONTROL)	
ONLY OF TRANSMISSION FACILITIES)	
LOCATED IN KENTCUKY TO PJM)	
INTERCONNECTION, L.L.C. PURSUANT)	
TO KRS 278.218)	

**MAIN BRIEF OF
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.**

Kentucky Industrial Utility Customers (“KIUC”) respectfully requests the Kentucky Public Service Commission (“Commission”) to deny the Application of Kentucky Power Company d/b/a American Electric Power (“Kentucky Power”) to transfer functional control of Kentucky Power’s transmission facilities located in Kentucky to PJM Interconnection, L.L.C. (“PJM”) Pursuant to KRS 278.218.

On May 7, 2002, AEP entered into a Memorandum of Understanding with PJM stating that several AEP operating companies, including Kentucky Power, agree to transfer control of their transmission facilities to PJM. In an order dated July 31, 2002, FERC conditionally approved AEP’s agreement with PJM as satisfying the requirements of FERC’s June, 2000 Order. On December 19, 2002 Kentucky Power filed its Application of Kentucky Power Company d/b/a American Electric Power

to transfer functional control of Kentucky Power's transmission facilities located in Kentucky to PJM Interconnection, L.L.C. Pursuant to KRS 278.218 ("Application") with the Commission. In its Application, Kentucky Power requests Commission approval of its tentative agreement with PJM and argues that the transfer of control of its transmission facilities to PJM is "*for a proper purpose and consistent with the public interest,*" pursuant to KRS 278.218.

ARGUMENT

1. **Kentucky Power Has Failed To Show That The Proposed Transaction, "Is For A Proper Purpose And Is Consistent With The Public Interest," In Accordance With KRS 278.218.**

In order for Kentucky Power to transfer control of its Kentucky transmission assets to PJM the Commission must approve the transaction upon a determination that the Applicant has shown that the transaction, "*is for a proper purpose and is consistent with the public interest,*" pursuant to KRS 278.218(2). Although AEP's agreement with PJM may be in the best interest of AEP and its out-of-state wholesale and retail customers, the phrase "public interest" as used in the Kentucky Revised Statute is defined as the public interest of Kentucky ratepayers. Kentucky Power has failed to establish that the transfer of control of its Kentucky transmission assets to PJM is in the best interest of Kentucky ratepayers.

Kentucky Power bears the burden of showing that its Application fulfills the requirements of KRS 278.218. Kentucky law requires an applicant before an administrative agency to prove by "*clear and convincing evidence*" that their application serves the public interest. Energy Regulatory Commission v. Kentucky Power, Ky. App., 606 S.w.2d 46, 50 (1980) ("*Applicants before an administrative agency have the burden of proof...[T]he petitioner must carry the burden of proof under*

a clearly convincing evidence standard.") See also Kentucky American Water Co. v. Com. Ex Rel. Cowan, Ky., 847 S.W.2d 737, 741 (1993).

Kentucky Power has not shown by clear and convincing evidence that the proposed transaction is for a proper purpose and in the best interest of Kentucky ratepayers. Kentucky Power has only vaguely identified potential benefits to Kentucky and has not conducted a cost/benefit analysis in order to quantify the potential benefits, costs and risks of joining PJM. Instead Kentucky Power is attempting to satisfy its burden of showing that the transaction is in the best interest of Kentucky ratepayers by citing generalized benefits unsupported by any specific evidence. Kentucky Power witness, J. Craig Baker states:

"Kentucky Power's participation in PJM, as part of the integrated AEP System, will benefit Kentucky electric customers by improving the reliability and competitiveness of interstate wholesale energy markets, and greatly expand the generation sources economically available to Kentucky customers. The resolution of seams issues between PJM and MISO pursuant to the FERC's July 31, 2002 Order will further enhance RTO benefits for Kentucky customers.

*Finally, AEP's participation in PJM, and the resultant transfer of Kentucky Power's transmission facilities, will promote construction of properly located generation that is the optimum solution."*¹

Kentucky Power made this and other similar statements in its Application and testimony before the Commission, but failed to support its enumeration of benefits with any evidence that such benefits will be achieved or that the alleged benefits of joining PJM are preferable to Kentucky Power's current administration of its transmission system. Kentucky Power did not conduct a cost/benefit analysis and failed to adequately address whether the identified benefits outweigh the many costs to Kentucky ratepayers associated with joining PJM.

Kentucky Power rationalizes its failure to produce meaningful support for its contention that joining PJM is for a proper purpose and consistent with public interest by deferring to Kentucky Power's

¹ TE at 10-11, Baker.

belief that AEP is required by the FERC Order approving AEP's merger with the former Central and South West Corporation ("CSWC") to, "*transfer operational control of their transmission facilities to a fully-functioning, [FERC]-approved RTO...*"² Kentucky Power is proceeding with its Application under the apparent assumption that FERC's Order, requiring AEP to join a RTO, excuses Kentucky Power from its burden under KRS 278.218. Kentucky Power witness J. Craig Baker explains the Company's lack of a cost/benefit analysis:

*No cost/benefit analysis has been conducted to evaluate the benefits of joining an RTO as compared to not joining an RTO because AEP is required to participate in an RTO as a condition of FERC's approval of its merger with the former Central and South West Corporation.*³

On cross-examination Mr. Baker elaborated on Kentucky Power's apparent position that it need not meet its KRS 278.218 burden as a result of the FERC Order:

*We performed no formal cost/benefit analysis. As we discussed earlier, AEP believes that, as a condition of its merger, it is required to join an RTO. We have looked and directionally we think there are some benefits associated with joining an RTO that will go somewhat to offset [Kentucky Power's \$3 million per year cost for membership in PJM], but have not formally calculated what those are.*⁴

In contrast to Kentucky Power's failure to adequately examine the impact of the proposed transaction upon Kentucky ratepayers, Kentucky Power has extensively examined the consequences of its affiliation with PJM with respect to the AEP system. On cross-examination Mr. Baker plainly concedes that AEP has analyzed the impact of joining PJM with respect to the AEP system as a whole, but has not examined its effect on the Kentucky Power system.

² Federal Energy Regulatory Commission, American Electric Power Co. and Central and South West Corp., Opinion No. 242, 90 FERC Par. 61, 242 (2000).

³ Commission Staff First Set of Data Requests, (February 19, 2003) Request No. 1.

⁴ TE at 12, Baker.

*An analysis was conducted for the AEP System, but there was no specific analysis on the impact on KPCo or any other particular operating company. The AEP system is operated as an integrated system, so a system-wide analysis is more appropriate.*⁵

Commission approval of the proposed transaction in light of Kentucky Power's failure to consider its impact on Kentucky ratepayers would effectively nullify KRS 278.218. Kentucky Power has clearly fallen short of its statutory burden.

Kentucky Power's failure to support its contention that transferring operational control of its transmission facilities to PJM is in the best interest of Kentucky ratepayers cannot conceal the probability that the \$3 million per year costs to Kentucky ratepayers of the proposed transaction will vastly outweigh its professed benefits.⁶

Kentucky ratepayers will likely receive little if any benefit from Kentucky Power's association with PJM, while bearing much of the cost. The purpose of PJM and other RTOs is to facilitate non-discriminatory access to bulk power markets through transmission service at non-pancaked rates to unbundled open access transmission customers. In Kentucky, where retail service is not unbundled, and where load is served mostly with generation sited within the utility's own service territory or under long term unit power contracts, there is little for PJM to do, as service is generally provided using the same transmission and generation facilities that have historically delivered and supplied power. Kentucky retail customers already benefit from low cost generation and do not need to access the bulk power markets provided by PJM in search of lower cost electricity.

Kentucky Power's contention that Kentucky ratepayers will benefit from increased reliability along its transmission system as a result of the proposed transaction is likewise doubtful. Kentucky Power was unable to identify any instances in the past three years in which Kentucky Power's native

⁵ Commission Staff First Set of Data Requests, (February 19, 2003) Request No. 2.

⁶ Responses of Kentucky Power to Commission Staff First Set of Data Requests. Question 7.

load customers received unreliable service that would not have occurred if Kentucky Power had been a member of PJM.⁷

Despite the likely result of the proposed transaction that Kentucky ratepayers' will not enjoy any substantial benefit, the transaction will produce significant costs born by Kentucky Power's native load customers. Kentucky Power estimates PJM administrative costs at \$3 million per year. This estimate does not take into account potential return on equity increases at FERC or congestion charges.⁸

In addition to the substantial administrative cost that will be allocated to jurisdictional ratepayers, the transfer of control of Kentucky Power's transmission assets to PJM will significantly impair the Commonwealth's ability to carry out its responsibility of insuring that Kentucky Power provides safe, reliable and low-cost power to Kentucky ratepayers. Furthermore, it is likely that once approved by the Commission such approval of the proposed transaction will not be easily retracted if PJM's control of Kentucky Power transmission assets proves to be detrimental to Kentucky.

Finally, the high costs and negligible benefits of a Kentucky utility's affiliation with an RTO are apparent from Louisville Gas & Electric Company's ("LG&E") and Kentucky Utilities' ("KU") membership in the Midwest ISO. Kentucky's experience with LG&E's/KU's transfer of control of its transmission assets to the MISO suggest that the cost of joining an RTO vastly outweigh the benefits for Kentucky.

⁷ Responses of Kentucky Power to Commission Staff First Set of Data Requests. Question 9.

⁸ TE at 30-31, Baker. An example of FERC generosity to transmission owners at the expense of ratepayers is exemplified in its treatment of a major transmission project in California. In In Re: Western Area Power Administration, the FERC awarded 13.5 percent return on equity (ROE) plus an incentive worth 200 basis points. It also granted a 10-year accelerated depreciation schedule for PGE and a 50/50 "hypothetical" capital structure which artificially inflated the equity component of capitalization. See. Docket No. ER02-1672, 99 FERC ¶61,306, rehearing denied, 100 FERC ¶61,331.

2. **FERC Does Not Have Jurisdiction To Force Kentucky Power To Transfer Control Of Its Transmission Assets To PJM.**

FERC's June, 2000, Order in Docket Nos. EC98-40-000 in which FERC required AEP to transfer control of its transmission facilities to a RTO as a condition of FERC's approval of AEP's merger with CSWC does not excuse Kentucky Power from meeting its burden of showing under Kentucky law that the proposed transaction is for a proper purpose and consistent with the public interest. The Kentucky Commission, not FERC, has the authority to determine whether Kentucky Power can transfer control over its transmission pursuant to KRS 278.218.

Kentucky Power's repeated statements that FERC "ordered" AEP and its affiliates to join an RTO as a condition of FERC approval of AEP's merger with the CSWC are misleading. FERC has not and cannot force Kentucky Power or any other utility to join an RTO. FERC is authorized to review and approve proposed mergers pursuant to Section 203 of the FPA. AEP voluntarily merged with CWSC and was free to abandon the planned merger at any time before, during or after its application to FERC for approval of the merger. If FERC attaches conditions to its approval of the merger that are in violation of Kentucky law, because the attached conditions are not in the best interest of Kentucky ratepayers pursuant to KRS 278.218, then the appropriate remedy at FERC is for FERC to retract its approval of the merger or redefine the terms of its approval. In the alternative, Kentucky Power could seek to have the legislature change KRS 278.218. But the only option for this Commission is to enforce KRS 278.218 as written.

FERC has no statutory authority to require Kentucky Power to transfer control of its Kentucky transmission facilities to an ISO or RTO. As a federal agency, FERC can exercise only as much authority as was conferred to it by Congress.⁹ An act of a federal agency is unlawful if the agency is not

⁹ Michigan v. EPA, 268 F.3d 1075, 1081 (D.C. Circ. 2001).

expressly or impliedly delegated by statute to take such action.¹⁰ FERC has not been granted the authority to require Kentucky Power to transfer control of its transmission facilities to PJM by the Federal Power Act or by any other act of Congress.

FERC's lack of authority to require a transmission owning utility to join or withdrawal from an ISO was at issue in Atlantic City Electric Co. v. FERC, 295 F.3d 1, 352 U.S.App.D.C. 1. In Atlantic City Electric v. FERC, the D.C. Circuit Court held that FERC exceeded its authority under the Federal Power Act when it required Atlantic City Electric Co. to obtain approval from FERC to withdrawal from PJM. FERC argued that it has authority to prevent a utility from withdrawing from an ISO under Section 203 of the Federal Power Act ("FPA"). Section 203 provides: "*No public utility shall sell, lease or otherwise dispose of,*" jurisdictional facilities whose value exceeds \$50,000, "*without first having secured an order of [FERC] authorizing it to do so.*" 16 U.S.C. §824b (a). FERC argued that the utility's transfer of control of its transmission facilities to PJM constitutes a "disposition" of facilities within the meaning of Section 203, thus giving FERC jurisdiction under that Section.¹¹ The D.C. Circuit Court rejected FERC's contention that Atlantic City Power Co.'s agreement with PJM fell within FERC's jurisdiction. Importantly, the Court held that FERC has no jurisdiction over a utility's withdrawal from an ISO or a utility's initial joining of an ISO.

[A] utility does not 'sell, lease, or otherwise dispose' of its facilities when it agrees to the changes in operational control necessary to initially join or to withdrawal from an ISO, [and], FERC exceeded its jurisdiction by directing the utility... to modify their agreement to state that any notice of withdrawal from the ISO shall become effective only upon FERC approval.¹²

Additionally, the D.C. Circuit Court reasoned, that FERC's overly broad construction of Section 203 was inconsistent with Section 202 of the FPA. In enacting Section 202, Congress clearly intended

¹⁰ Id. at 1119-20.

¹¹ Atlantic City Electric Co. v. FERC, 295 F.3d 1, 353 U.S.App.D.C. 1. At 11.

¹² Id. at 11.

“coordination and interconnection agreements to be left to the voluntary action of the utilities.” Section 202 provides that *“the [FERC] is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy.”* The D.C. Circuit Court held that that provision does not provide FERC with any substantive powers, *“to compel any particular inter-connection or technique of coordination.”* See also Duke Power Co. v. FPC, 401 F.2d 930, 943 (D.C. Cir. 1968); Central Iowa Power Corp. v. FERC, 6060 F.2d 1156, 1167-68 (D.C. Cir. 1979).

States have authority over transmission and generation facilities constructed within their borders. It is the states that authorize the construction of these facilities and issue certificates to public utilities to operate them. This long-standing rule is settled common law. See Arkansas Elec. Coop. v. Arkansas Pub. Serv. Comm’n, 461 U.S. 375, 377, 103 S.Ct. 1905, 76 L.Ed.2d 1 (1983). (*“[T]he regulation of utilities is one of the most important of the functions traditionally associated with the police power of the State.”*)

The Commission must accept KRS 278.218 as valid and constitutional in all respects. It is settled law in the Commonwealth that an administrative agency cannot decide constitutional issues. Commonwealth DLX, INC., 42 S.W.3d 624, 625 (KY, 2001); See Goodwin v. City of Louisville, 215 S.W.2d 557, 559 (KY, 1948); Blue Diamond Coal Co. v. Cornett, 189 S.W.2d 963 at 964 (1945) (*“[T]he Tax Commission is only an administrative body and cannot act in a judicial capacity”*). Accordingly, this Commission has no authority to temper or modify its opinion as to the validity of KRS 278.218. This Commission must enforce KRS 278.218 as written.

3. **Membership In PJM Would Result In This Commission's Loss Of Control Over Transmission And Generation. FERC Has No Jurisdiction Over Generation.**

Despite the well-established principle that local generation is not subject to FERC jurisdiction, AEP's interpretation of FERC's June, 2000 Order would have the effect of conferring control over the generation assets of Kentucky Power to FERC. As a corollary of joining PJM, Kentucky Power will have to turn over substantial control over its generation assets. AEP concedes that the transfer of Kentucky Power transmission assets to PJM necessitates a transfer of control of generation as well. "[PJM] can require AEP to re-dispatch generating units to relieve congestion. There is also a coordination function that they perform as far as scheduling of generation outages."¹³ The scheduling of generation outages is clearly an infringement on this Commission's jurisdiction over generation. PJM control of Kentucky Power transmission assets also opens the door to conflicts between Commission approved and PJM required reserve margins; another area that can potentially infringe upon the Commission's jurisdiction over generation.

Other state commissions that have addressed the issue of whether it is in the best interest of in-state ratepayers to permit PJM to take operational control over transmission facilities have expressed similar concerns that PJM control of transmission assets requires corresponding control of generation assets. In arguing that FERC cannot unilaterally order the transfer of control of transmission facilities belonging to AEP's operating companies to PJM without such companies obtaining the prior approval of those states whose laws obligate them to provide prior approval, the Virginia State Corporation Commission ("the VSCC") noted that the transfer of control of transmission assets to PJM requires a substantial transfer of control of generation assets. In its Answer to the Motion for Relief of the Michigan, Ohio and Pennsylvania Commissions and to the Motion of Exelon Corporation and

¹³ TE at 32, Baker.

Commonwealth Edison Company for Expedited Decision on Pending Applications to Join PJM, the VSCC states:¹⁴

“Membership in PJM ..., means nothing less than a utility’s substantial relinquishment of its control and coordination of generation as well as transmission. PJM oversees generation pricing, economic dispatch, reliability, reserve setting, and the provision of generation –based ancillary services. Thus, transfer of control of transmission assets located in Virginia to PJM transfers significant control over the operation and reliability of electric generation serving the Commonwealth.”¹⁵

Kentucky Power’s membership in PJM requires the surrender of substantial control and coordination of generation as well as transmission assets. Consequently, the Commission is well within its jurisdictional charge to determine whether the transfer of control over Kentucky Power’s transmission system, and to a large extent its generation assets, to PJM is in the public interest; because the Commission, not FERC has jurisdiction over electric generation in Kentucky.

Section 201 of the FPA specifically reserves the authority to regulate electric generation to the states.

The [FERC] shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy” Section 201(b).

The courts and FERC itself have historically recognized the limits of FERC’s jurisdiction over generation. In New York v. FERC, 535 U.S. 1, 122 S.Ct 1012, (2002), the Supreme Court stated:

“Moreover, FERC has recognized that the States retain significant control over local matters even when retail transmissions are unbundled. (‘Among other things, Congress left to the States authority to regulate generation and transmission siting’); (‘This Final Rule will not affect or encroach upon state authority in such traditional areas as the authority over local service issues, including reliability of local service; administration of

¹⁴ Answer of Virginia State Corporation Commission to the Motion for Relief of the Michigan, Ohio and Pennsylvania Commissions and to the Motion of Exelon Corporation and Commonwealth Edison Company for Expedited Decision on Pending Applications to Join PJM, Before the Federal Energy Regulatory Commission. Docket Nos. ER03-262-000, ER03-262-001, EC98-40-000, EC98-2770-000 and EC98-2786-000. (April 1, 2003).

¹⁵ Id. at 6.

integrated resource planning and utility buy-side and demand- side decisions, including DSM [demand-side management]; authority over utility generation and resource portfolios; and authority to impose non-bypassable distribution or retail stranded cost charges’.” *Id.* at 1026.

See also Pacific Gas and Electric Co. v. State Energy Resources, 103 S.Ct. 1713, 1723 (1983)

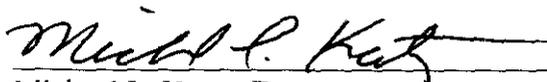
(“Need for new power facilities, their economic feasibility, and rates and services, are areas that have been characteristically governed by the States.”);

It is universally recognized that Congress expressly reserved the authority to regulate electric generation to the states. FERC does not have the authority to assert control over generation reliability, reserve margins, economic dispatch, generation pricing, etc., each of which is demanded by Kentucky Power’s possible association with PJM.

CONCLUSION

Kentucky Power has not met its burden of showing that the transfer of control of its transmission facilities to PJM is for a proper purpose and in the best interest of Kentucky ratepayers pursuant to KRS 278.218. FERC does not have the authority to compel Kentucky Power to join a RTO. RTO membership would infringe upon this Commission's jurisdiction over generation. Finally, as a state with low cost generation and reliable transmission, any benefit to Kentucky from the proposed transaction is outweighed by the substantial costs. KIUC requests the Commission deny the Application.

Respectfully submitted,



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